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on Military Readiness, Committee on
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BASE OPERATIONS

Challenges Confronting DOD as It Renews Emphasis on Outsourcing



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National Security and
International Affairs Division

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The Honorable Herbert H. Bateman
Chairman, Subcommittee on Military Readiness
Committee on National Security
House of Representatives

Dear Mr. Chairman:

"Outsourcing," or contracting out, for commercial services is a growing practice within the government to achieve cost savings, management efficiencies, and operating flexibility. Recent studies have noted that the Department of Defense (DOD) could save billions of dollars by outsourcing support functions associated with operating military bases. In response to your request, we have developed information about outsourcing savings. This report examines (1) the extent to which DOD and the services emphasize the outsourcing of base support services, (2) the factors that influence savings in the outsourcing process, and (3) impediments to DOD's outsourcing.

Results in Brief

DOD's efforts to outsource base support activities were constrained by legislation and other factors in the past. Because of the continuing budgetary and personnel limitations, the need to fund weapons modernization, and the elimination of key legislative constraints, DOD is now increasing its emphasis on outsourcing support activities. Senior leadership within the Office of the Secretary of Defense (OSD) and the services are strongly supporting renewed efforts to outsource base support activities. From October 1, 1995, to January 15, 1997, the services announced plans to begin outsourcing studies during fiscal years 1996 and 1997. These studies will involve over 34,000 positions, most of which were associated with base support activities. Additional studies involving more than 100,000 positions will be started over the next 6 years.

Although the outsourcing studies have yet to be completed, some of the services have programmed outsourcing savings projections into their budgets. We recognize that outsourcing can be cost-effective because outsourcing competitions generate savings, usually through a reduction in personnel, whether competitions are won by the government or the private sector. However, we question the magnitude of savings projections cited in various DOD studies, as well as the services' current savings projections. These estimates are heavily premised on initial savings

estimates from previous outsourcing efforts, and such estimates change as the scope of the work and wages change. Furthermore, continuing budget and personnel reductions could make it difficult to sustain the levels of previously projected savings. Thus, the extent to which the services may achieve these savings is questionable. At the same time, two areas of outsourcing appear to offer the potential for significant savings, but the extent to which the services are exploring them is mixed. They involve giving greater emphasis to (1) the use of omnibus contracts, rather than multiple contracts, for support services and (2) the conversion of military support positions to civilian or contractor positions.

Despite DOD's renewed emphasis on outsourcing, impediments remain and new challenges are emerging. Although guidance for performing outsourcing studies has recently been changed to streamline and improve the process, the extent to which the guidance will lead to increased outsourcing remains to be seen. Also, federal contracting law may affect some DOD efforts to outsource, and some services preclude some activities from outsourcing because of military requirements. Finally, the potential lack of resources to perform outsourcing studies and funding to pay for outsourced activities is of growing concern to some service officials.

Background

Since 1955, federal agencies have been encouraged to obtain goods and services from the private sector through outsourcing. In 1966, the Office of Management and Budget (OMB) issued Circular A-76, which established the federal policy for the government's performance of commercial activities. In a 1983 supplemental handbook, OMB established procedures for determining whether commercial activities should be outsourced.¹

Under A-76, DOD has historically outsourced functions to provide more cost-effective services. However, several provisions of law have inhibited DOD's outsourcing efforts. The first provision contained in the National Defense Authorization Act for Fiscal Years 1988-89 (P.L. 100-180) authorized installation commanders to determine whether to study activities for potential outsourcing. Because of disruptions to

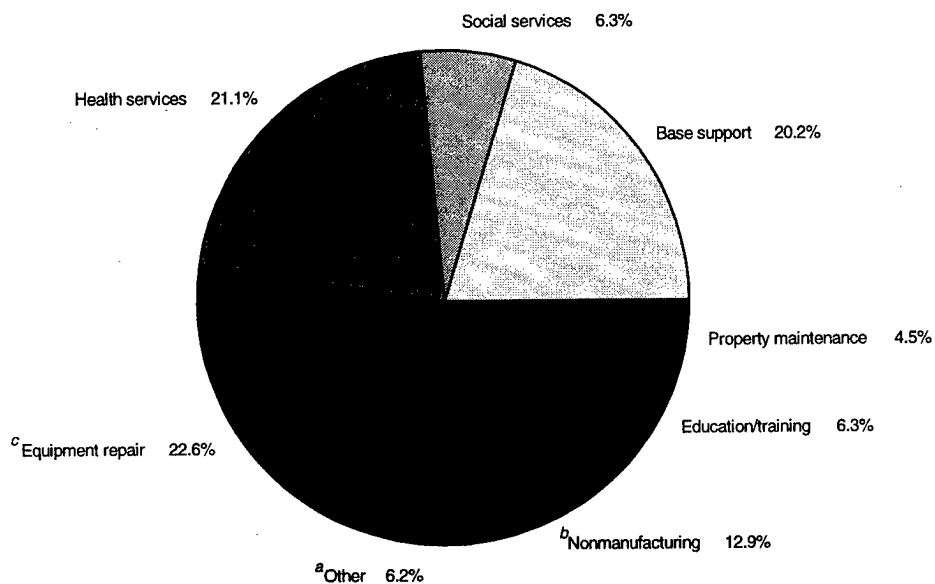
¹To compare costs associated with in-house versus industry performance, the supplemental handbook requires the government to conduct a management efficiency study. In this study, organizational structure, staffing, and operating procedures are reviewed to determine the most efficient and effective way of performing the activity with in-house staff. The resulting "most efficient organization" is used as the basis for the in-house cost. The government also prepares a performance work statement describing the work required, which serves as the basis for both contractor and in-house offers. Each of the services maintains a database of all A-76 studies. This database generally includes the function studied, the cost of the in-house workforce and contract, and the outcome of the competition.

their workforce, the cost of conducting studies, and a desire for more direct control of their workforce, various officials told us that commanders often chose not to pursue outsourcing. This law, which was known as the "Nichols Amendment" and codified at 10 U.S.C. 2468, was effective through September 30, 1995. Another provision contained in the Department of Defense Appropriations Act for Fiscal Year 1991 (P.L. 101-511) and subsequent DOD appropriations acts, prohibited funding for lengthy A-76 studies. Finally, the National Defense Authorization Acts for Fiscal Years 1993 and 1994 contained provisions that prohibited DOD from entering into contracts resulting from cost studies done under OMB Circular A-76, from October 23, 1992, to April 1, 1994. These prohibitions, along with the Nichols Amendment, had the effect of limiting outsourcing in most services until 1996. Since then, except for the Air Force, the services have completed few A-76 studies. In 1996, OMB revised its supplemental handbook in an effort to streamline and improve the outsourcing study process. (See app. I for a summary of the changes.)

As of fiscal year 1996, DOD employed about 449,000 military and civilian personnel to do support activities such as base support, health services, and equipment repairs in-house (see fig. 1).²

²Other DOD-sponsored studies that take a broader view of infrastructure and support activities indicate that the total number of DOD military and civilian personnel involved in such activities could be much higher. The services differ in how they (1) define commercial activities and (2) determine which activities and functions are inherently governmental, requiring that they be done in-house.

Figure 1: In-house DOD Commercial Activities (fiscal year 1996)



Note: Percentages indicate the portion of the in-house workforce involved in commercial activities.

^aOther includes research, development, test, and evaluation support; automatic data processing; and products manufactured in-house.

^bNonmanufacturing includes functions such as storage and warehousing, engineering, and administrative support services.

^cEquipment repair includes depot and intermediate maintenance.

Source: DOD's 1996 commercial activities inventory.

DOD estimates that base support activities such as facilities and vehicle maintenance, food services, and local transportation will cost more than \$30 billion in fiscal year 1997. (App. II provides a more detailed list of base support functions.) Several recent studies—DOD's 1993 Bottom-Up Review, the 1993 National Performance Review, DOD's 1995 report from the Commission on Roles and Missions of the Armed Forces, and the 1996 report of the Defense Science Board Task Force on Outsourcing and

Privatization—concluded that DOD could realize savings of upwards to between 20 and 40 percent by outsourcing support activities. Some further concluded that DOD could achieve the largest savings by using a single omnibus contract, rather than several small contracts, to encompass multiple activities.

Over the years, we have done many reviews of federal contracting, addressing issues associated with outsourcing and questions regarding cost savings. A list of related GAO products is presented at the end of this report.

DOD and Services Have Renewed Emphasis on Outsourcing

After a lull in outsourcing efforts due to administrative and legislative constraints, in August 1995, the Deputy Secretary of Defense directed the services to make outsourcing of support activities a priority and chartered a Privatization Integrated Policy Team to identify opportunities for outsourcing.³ In doing so, he was reacting to the reports recommending outsourcing of support activities, increasing budget pressures, and the need to free up funding for modernization. Consequently, DOD and the services initiated a review of six support areas, including base support, to determine where outsourcing could generate savings.⁴

As of the beginning of fiscal year 1996, DOD officials estimated that DOD had outsourced about 37 percent of its overall workforce connected with commercial activities. Based on service definitions of commercial activities, the Air Force estimated that it had outsourced 64 percent of its workforce performing commercial activities, and at the end of 1996, the Air Force had 126 A-76 studies underway—significantly more than the other services. The Army and the Navy estimated they had outsourced 32 and 31 percent, respectively.⁵

The Air Force plans to study up to 60,000 positions for potential outsourcing beginning in 1996 through 2003. Air Force officials estimated that the majority of the positions are in base support services. In January 1997, Air Force officials announced plans to study about 14,400

³For DOD's purposes, outsourcing is the use of federal funds to pay a private company to do defense work or provide a service for a defense activity; privatization is the complete transfer of ownership and management of a function to the private sector, but DOD pays for the services associated with the function.

⁴The other five areas under review are materiel management, depot maintenance, finance and accounting, education and training, and data centers.

⁵Because each service differs in how it defines commercial activities, the totals could be increased as the services reexamine areas previously excluded.

positions. To organize its efforts, the Air Force formed an outsourcing and privatization team and executive steering group in January 1996 and a new outsourcing and privatization division in January 1997. Also, an Air Force Center for Quality Management Innovations is expected to facilitate Air Force-wide outsourcing and privatization efforts.

The Army plans to study about 11,000 positions during fiscal year 1997 and about 15,000 positions during fiscal years 1998-2003 for potential outsourcing. An Army official estimated that most of the positions are in base support functions and that the majority are civilian positions. As of January 1997, the Army had announced plans to begin studying about 9,600 positions for potential outsourcing, all of them in base support functions.

Navy officials told us that they plan to study about 80,000 positions for potential outsourcing over the next several years. These positions represent about 50,000 civilians and 30,000 military members, and a portion of them are involved in base support functions. In January 1997, the Navy formally announced plans to study about 10,600 positions beginning in fiscal year 1997. Of the 10,600, about 8,400 involve civilian and 2,200 involve military positions. In 1996, the Navy established an outsourcing support office to contract with industry to conduct A-76 studies and develop tools to streamline the study process. Further, the Navy established a new outsourcing program division to identify outsourcing candidates and fund A-76 studies. A Navy survey of commercial activities to identify candidates for competition is underway.

The Marine Corps estimates it will study 5,000 positions for outsourcing; however, it does not have a firm timetable for initiating or completing its studies. In 1996, the Marine Corps established a senior staff-level committee and working group to guide the selection of candidate functions for outsourcing. The Marine Corps is part of the Navy's survey of commercial activities. Marine officials indicated that survey results are expected to be available in the summer of 1997.

History and Current Environment Suggest the Need for Caution in Projecting Savings From Outsourcing

DOD is expecting significant savings from its current and planned outsourcing and privatization efforts. However, DOD's outsourcing experience and the current operating environment suggest that projected savings from current and planned outsourcing efforts may be overstated. At the same time, opportunities exist for greater savings through omnibus

contracting and military-to-civilian conversions, although they, too, have limitations.

DOD's Projected Savings From Outsourcing Initiatives

A DOD official told us that the Department expects savings from outsourcing and privatization to grow to at least \$2.5 billion annually by the end of the future years defense plan period (fiscal year 2003); however, he could not tell us specific savings totals for each year before 2003. According to OSD and service officials, DOD has programmed the savings into its 6-year budget. In February 1996, the Deputy Secretary of Defense directed the services to identify targets for savings from outsourcing and privatization and to transfer the anticipated savings from their operations and maintenance accounts to their modernization accounts. Each of the services has projected potential savings based on outsourcing programs planned or underway. These savings projections are not as large as some studies had suggested were possible from outsourcing; still, caution is warranted concerning the magnitude of savings likely to be achieved in the current operating environment.

The Air Force projects a 20-percent cost savings of up to \$1.26 billion from outsourcing mostly base support functions between fiscal year 1998 and 2003. Air Force officials told us that prior outsourcing experience projected an average 29-percent savings; thus, they considered their current savings projection to be conservative. The Air Force projects that its studies will recommend outsourcing about 12,000 positions. Air Force officials could not tell us what portion of the 12,000 were military or civilian positions because they had not identified specific functions to be outsourced.

Until recently, the Army was projecting a 10-percent savings from its renewed outsourcing emphasis, and a key program official was expressing concern about the program's ability to produce large-scale savings. Now, while still expressing concern about the potential savings, this official told us the Army was raising its savings projection to 20 percent, which is more in line with savings projections being cited by the other services.⁶ He said that the 20-percent figure represented a conservative application of Center for Naval Analyses (CNA) study data, which estimated the Army has saved 27 percent from outsourcing studies.⁷

⁶In neither case did Army officials provide us with a dollar amount for projected savings.

⁷See DOD report to the Congress, March 1996, *Improving the Combat Edge Through Outsourcing*, completed in response to section 357 of the National Defense Authorization Act for Fiscal Year 1996.

The Marine Corps projects initial cost savings of about \$10 million per year beginning in fiscal year 1998, increasing to \$110 million per year by fiscal year 2004. Officials told us the Marine Corps estimate was based on CNA study data. The CNA study data had projected that the Marine Corps could save 34 percent through outsourcing, based on prior years' savings projections.

The Navy projects a 30-percent net cost savings from outsourcing commercial activities, beginning in fiscal year 2000, based on the results of CNA study data. The Navy expects savings to begin accruing in fiscal year 2000 and increase to \$1.3 billion per year by the end of fiscal year 2003.

Competition Generates Savings, but They May Be Less Than Initially Projected

Some recent studies recommending increased outsourcing within DOD have projected cost savings of 20 to 40 percent and generally created the impression that large savings occur only if contracts are awarded to the private sector. Our work indicates that the magnitude of savings from outsourcing over time is likely to be less than projected from initial cost comparisons. Even so, competition is the key to realizing some savings, whether the function is outsourced or remains in-house.

According to DOD data on cost comparisons done between fiscal year 1978 and 1994, savings from competed functions occurred regardless of whether the government or a private company was awarded the work. DOD's data show the government won about half of the time and private industry won the other half. DOD's savings achieved through the competitive process were largely personnel savings, the result of closely examining the work to be done and determining how to do it with fewer personnel, whether in-house or outsourced. This lesson was consistent with an April 1996 CNA report, which stated that the Navy's cost estimates were lower than private industry about 40 percent of the time. CNA concluded that competition, not outsourcing, was the key to savings because winners of competitions, whether an in-house organization or a contractor, generally used fewer people to do the work.

Although a number of recent studies cited the potential for outsourcing to provide large savings, most studies we examined, including those from CNA and the Defense Science Board, drew heavily from the initial savings projections in DOD's commercial activities database. This database, individually maintained by each of the services, set forth operational savings that represent the difference between the cost of the ongoing

operation and the cost of the winning offer. The services are required to track these savings for the first 3 years. However, the services' databases do not generally reflect savings actually attained beyond 3 years, which are subject to change.

Service officials acknowledged that the cost of operations projected at the time of an outsourcing competition may be subject to modification for a variety of reasons, such as inadequate initial statements of work, other changes to performance work statements necessitated by new missions, and mandated increases to wages. According to various headquarters and installation officials, inadequately crafted statements of work have frequently necessitated changes to contracts, which usually have resulted in cost increases.⁸ Likewise, headquarters and installation officials often cited increases in federally established wage rates—larger at times than wage increases received by federal employees—as a source of increased contract costs. The Service Contract Act of 1965, as amended (41 U.S.C. 351-358), requires federal contractors to pay their service employees not less than the prevailing wage as determined by the Department of Labor, based on the type of work and the locale. When the prevailing wage increases, contracts must be modified to reimburse contractors for the increased cost.

Although DOD's commercial activities database provides an initial projection of savings from outsourcing competitions, few studies have been done to determine actual savings realized over time. Various headquarters and installation officials told us that such studies are time-consuming and costly and are difficult to do, since a common baseline for comparison is typically lost over time. Our 1990 evaluation of DOD savings data showed that neither DOD nor OMB had reliable data on which to assess the soundness of savings estimates. Also, DOD and OMB did not know the extent to which expected savings were realized because DOD does not routinely collect and analyze cost information to track savings after the first 3 years of a contract.⁹ Furthermore, DOD does not capture what many service officials consider to be the sizable costs associated with conducting A-76 studies.

⁸Various service initiatives are underway to improve the development of performance work statements through the use of standard templates, expert study teams to conduct A-76 studies, and outsourcing the entire A-76 study process. Such steps could help to mitigate, but not eliminate, the need for contract changes.

⁹OMB Circular A-76: DOD's Reported Savings Figures Are Incomplete and Inaccurate (GAO/GGD-90-58, Mar. 15, 1990).

Because post-contract reviews of activities outsourced have been limited, we do not believe they provide a basis for projecting with reliability the magnitude of savings achieved over time. Nevertheless, they do suggest some potential for continuing savings, since many of the reviews indicated that savings continued over the life of the contracts. For example, a 1989 Army Audit Agency review found that 9 of 10 large contracts audited were still saving money after several years of operation. However, the scope of work on the 10th contract had changed so dramatically that comparative costs of in-house and contract operation could not be identified. According to a Navy official, Naval Audit Service reviews of selected contracts during the mid-1980s found that savings were realized over the life of the contracts, although not as much as initially projected.

Our prior reports have identified savings and cost increases over time from outsourcing. For example, in 1985, we reported that from a sample of 20 functions contracted out, savings were realized on 17 functions.¹⁰ Savings were not realized on two functions, and we could not determine whether savings were realized on the third function. Even so, all but 1 of the 20 functions had contract cost increases. Costs increased primarily because of added work and mandated wage increases. Further, a 1995 DOD Inspector General audit report found cost growth in 20 commercial activity contracts it reviewed. The increases were related to changes in work requirements and mandated wage increases associated with the Service Contract and Davis-Bacon acts.¹¹ The report also noted that increased contract requirements would have affected both in-house and contract costs but that the increased contract work requirements could render the original cost comparison invalid.¹²

Many installation officials we met with suggested that a variety of factors associated with the current operating environment could lessen the future potential for savings, regardless of past savings. They expressed concern that budget reductions and civilian personnel downsizing of recent years had eliminated much of the potential for additional personnel savings in

¹⁰DOD Functions Contracted Out Under OMB Circular A-76: Contract Cost Increases and the Effects on Federal Employees (GAO/NSIAD-85-49, Apr. 15, 1985).

¹¹Similar to the Service Contract Act, the Davis-Bacon Act, 40 U.S.C. 276a et. seq., requires that federal construction contractors pay their workers not less than prevailing wages as determined by the Department of Labor.

¹²Cost Growth in Commercial Activity Contracts, Mar. 31, 1995.

new outsourcing studies.¹³ Some said that potential savings from outsourcing may be minimized by increases in the scope of work. Such increases can occur, when funding becomes available, to restore a level of service that had been reduced due to resource constraints. For example, various officials expressed the need or potential for increases in the work level to redress the effects of postponing maintenance and repair activities, a common base support-type function, due to reductions in funding.

Various installation officials told us that one way of achieving across-the-board personnel reductions mandated by OSD is to outsource, which would free remaining civilian authorizations for use in other, critically understaffed activities. One senior command official in the Army stated that the need to reduce civilian positions is greater than the need to save money. This view was reinforced by the DOD Inspector General's 1995 report on cost growth, which noted that "the goal of downsizing the Federal workforce is widely perceived as placing DOD in a position of having to contract for services regardless of what is more desirable and cost effective."

Potential Areas for Significant Savings

Both omnibus contracting and the conversion of military positions to civilian or contractor performance appear to have the potential to yield larger savings than those projected from current or planned DOD outsourcing efforts. However, the services could face significant constraints on their abilities to achieve savings in these areas.

Omnibus Contracting

Despite recent studies highlighting the potential for larger savings from omnibus contracting than from contracting piecemeal, the extent to which the services plan to emphasize omnibus contracting is unclear. Emphasis on omnibus contracting may be constrained by competing DOD goals, such as the goal to provide contracting opportunities for small and disadvantaged businesses.

Currently, few installations have omnibus support contracts. The Army's Fort Irwin, California, and the Navy's submarine bases at Bangor,

¹³From fiscal year 1987 to 1996, total operations and maintenance (O&M) budget authority declined 25 percent in real terms, reflecting the overall decline in defense spending. The O&M funding appropriation account provides the principal source of funds for day-to-day activities at the services' installations and bases, including maintenance and repair of most facilities and civilian personnel pay. Within O&M funding, even steeper reductions have occurred in obligations for facilities maintenance and repair, a common base support function, declining 38 percent in real terms during the same period. During the same period, DOD's civilian workforce has declined by 27 percent and is expected to decline by 33 percent by fiscal year 2002.

Washington, and Kings Bay, Georgia, outsourced support services under single contracts when the current organizations were first established. Others, such as Vance Air Force Base, Oklahoma, outsourced in 1962 as part of a test with another base to determine whether outsourced support services were less costly than support services performed in-house. The former Craig Air Force Base in Selma, Alabama, retained all support functions in-house, while Vance Air Force Base outsourced all support. Vance Air Force Base retained its omnibus contract because Air Force officials concluded the contract was less costly than having services done in-house.

While DOD's experience with omnibus contracts has been limited, some of the services' outsourcing experiences suggest the potential for larger savings and benefits from such contracts. According to officials at one installation, significant savings are realized by competing functions that have large numbers of workers. Although there are few examples of omnibus contracting, Air Force and Navy contracting data showed that a higher percentage of savings was achieved in cases where large functions were competed. For example, Air Force data showed that functions with 1 to 25 positions averaged 13 percent in staff savings, while functions with over 300 positions averaged 41 percent in staff savings. The Navy data showed that functions with 1 to 10 positions averaged 22 percent in savings, while functions with over 200 positions averaged 35 percent in savings.

A 1996 internal assessment by the Army's Forces Command identified several benefits of omnibus contracting. Examples of benefits are (1) a single manager is held accountable for performance; (2) efficiencies, such as reduced overhead, are more often achievable under an omnibus contract than under separate contracts; and (3) the flexibility to change the contract performance work statement is increased. The assessment concluded that the greatest advantage of omnibus contracting was the reduced effort and cost to develop and award one contract versus multiple contracts. A 1984 government-sponsored study concluded that Vance Air Force Base was able to implement several organizational and managerial cost-saving initiatives because of its omnibus support contract and that such savings would not have been possible under the usual installation structure involving several contractors and in-house organizations. Similarly, a 1991 Air Force report concluded that the Vance omnibus contract resulted in an overall lower contract cost for the same service compared to individual contracts at similar installations.

Conversely, while omnibus contracts may produce larger savings, such contracts do not always succeed or are sometimes viewed as having drawbacks. For example, in 1996, the Army awarded five separate contracts to replace its omnibus contract to provide base support services to Fort Irwin. Army officials stated that the omnibus contract was replaced because the contract was too large to manage and the quality of service was not maintained for some portions of the contract.¹⁴ At installations we visited, we encountered varying views regarding omnibus contracts. Some officials viewed them as a more efficient way to manage, while others cited the potential for a greater number of activities to be adversely affected should contract problems arise.

On October 28, 1996, the Deputy Secretary of Defense issued a policy statement concerning the consolidation of contracts. In it, the Deputy Secretary announced that in planning to consolidate several contracts or requirements, the services must consider the effect on small businesses. According to the Deputy Secretary, requirements cannot preclude small businesses as prime contractors unless a market research analysis shows significant benefits in terms of reduced costs and services or both.

Omnibus contracts can exclude the participation of small businesses as the prime contractor because they often do not have the capacity to fulfill the various parts of single, large contracts. The policy statement recognizes the balance that must be maintained between the cost benefits that can be obtained through consolidated contracts and the loss of small businesses' participation. The Deputy Secretary's statement also recognizes the policy of fostering the participation of small business in federal contracting embodied in statutes such as the Small Business Act and section 2323 of title 10 as implemented by the Federal Acquisition Regulation (FAR) and the Defense Federal Acquisition Regulation Supplement (DFARS).

Small business policies that could affect the use of omnibus contracts include the requirement contained in FAR 19.502-2 that an acquisition be set aside for exclusive small business participation if there is a reasonable expectation that offers will be obtained from at least two responsible small businesses and that the award will be made at a fair market price. If DOD is considering a consolidation of services currently done by small businesses, under section 15(a) of the Small Business Act, it must also consider alternative procurement methods that would increase small business opportunities (15 U.S.C. 644(a)).

¹⁴Our review did not examine this contract in-depth to assess why it did not succeed.

The use of omnibus contracting must also be consistent with the mandate for full and open competition contained in the Competition in Contracting Act of 1984. The use of an omnibus contract could restrict such competition because multiple requirements are combined into one contract. Therefore, such a contract must represent DOD's legitimate needs, rather than administrative convenience or unsupported claims of economy.

Because of legislation and policy that affect the ability of an activity to consolidate activities for outsourcing, the services' plans to outsource through omnibus contracts are uncertain. Officials at the Army's Training and Doctrine Command and U.S. Forces Command told us they are planning to study the potential for outsourcing all logistics and public works functions at installations under omnibus contracts. These functions make up the majority of support activities on Army installations.¹⁵ However, according to an official at the Army's Training and Doctrine Command, the command has not yet dealt with the potential effect of the policies associated with small businesses.

Conversely, various Air Force installation officials told us that they had encountered problems with omnibus contracts for base support services in the past, even though the contracts resulted in significant savings, and they foresee problems in being able to use omnibus contracts in the future. Air Force headquarters officials said that while they encourage commands to outsource under omnibus contracts, the decision to do so is left to the field commander.

In January 1997, the Navy directed field activities to consider omnibus contracting where possible. Field activities decide whether to consolidate activities for study purposes. Recently announced study plans indicate that some activities will be combined. The Marine Corps has not yet determined what functions it will study.

Military-to-Civilian Conversions

Historical data suggest the potential for significant savings from converting military support positions to government civilian or contractor positions. The April 1996 CNA report concluded that competing activities done by military personnel yielded the highest percentage savings—50 percent, on average. Our 1996 report also illustrated the

¹⁵Army logistics functions include vehicle maintenance, supply, food service, and transportation of military and civilian personnel. Public works functions include the maintenance and repair of buildings and grounds.

potential for significant cost savings from such conversions.¹⁶ The extent to which the services' outsourcing studies will involve military positions remains unclear.¹⁷

At the same time, the conversions could be a time-consuming and difficult process within DOD, since they would involve changing how funding is provided between two different appropriation accounts—a centralized military personnel account and an installation's O&M account. Service officials told us that because of the budget/appropriations process, changing funding from the military personnel account to the O&M account to pay for civilian or contractor functions could take up to 2 years. In responding to our previous recommendations to convert military positions to civilian positions, OSD stated such conversions were impeded by the lack of consistent funding for the hiring of the civilian replacements, the ongoing civilian personnel drawdown, and the established minimums for military strength. The conversion of military positions to civilian or contractor positions could result in changes to military end strength. Without reductions to military end strength authorizations, the conversion of military functions will not produce the expected personnel savings.

Some Historical Impediments to Outsourcing Have Been Addressed, but Others Remain

Historically, impediments to outsourcing have included institutional resistance, extensive requirements of the A-76 process, and legislative barriers. Changes have been made in these areas to lessen the impediments to varying degrees; however, some impediments remain.

Institutional Effects on Outsourcing

In the past, institutional resistance to outsourcing, and legislation that contained prohibitions regarding the A-76 process and gave installation commanders the authority to forgo outsourcing, served to limit efforts to outsource commercial support activities. Recently, the strong leadership of OSD and the services, as well as funding and personnel reductions, were cited by various service officials as important elements to reduce the resistance to outsourcing. Yet, some institutional barriers to outsourcing remain.

¹⁶DOD Force Mix Issues: Converting Some Support Officer Positions to Civilian Status Could Save Money (GAO/NSIAD-97-15, Oct. 23, 1996).

¹⁷The DOD fiscal year 1994 inventory shows almost 300,000 military performing commercial-type activities. A Defense Science Board 1996 summer study, *Achieving an Innovative Support Structure for 21st Century Military Superiority*, notes that 40 percent of active duty military are in infrastructure versus war-fighting positions.

The services have for a long time set aside positions in support activities to ensure adequate opportunities to rotate military personnel from overseas locations or sea duty to tours of duty in the continental United States. For activities with such military positions, the services generally blocked the consideration of outsourcing. Over the years, the Army has converted many of its military positions set aside for rotation purposes to civilian positions. As such, the Army does not consider rotation requirements a barrier to outsourcing. The Air Force and the Navy, on the other hand, have relatively more commercial activities with positions reserved for military rotation.

Because of the recent emphasis placed on outsourcing, the Air Force and the Navy have begun to review ways to restructure activities with rotation positions to compete the activities for outsourcing. Because such efforts are in the beginning stages, however, it is uncertain to what extent these efforts will free up commercial activities for outsourcing.

A-76 Study Process Requirements

As discussed in appendix I, OMB recently revised its supplemental handbook to Circular No. A-76 in an effort to streamline and improve the A-76 study process. The effect of the revised handbook is uncertain, however, since DOD has not yet completed any study using the new supplement. DOD officials have expressed differing views on the revised handbook. Some approved of the revised handbook, while others said they would like the A-76 process to be eliminated.¹⁸

Although the revised handbook allows each service Assistant Secretary to waive A-76 studies under certain circumstances, the services' headquarters have received few requests to do so. Officials said they expect more requests as installation outsourcing programs mature. However, a recurring provision in section 8015 of the Department of Defense Appropriations Act for Fiscal Year 1997 (P.L. 104-208) requires DOD to certify in-house cost estimates before converting most DOD activities with more than 10 civilian employees to the private sector. The provision, in essence, restricts DOD's use of the new waiver authority.

¹⁸It should be noted that an A-76 study is not required to convert functions with 10 or fewer positions or outsource emerging requirements, such as new functions. DOD is considering the possibility of avoiding A-76 studies by eliminating a given function as a government activity and relying on the private sector for its provision (privatization). Various DOD and service officials indicated that the latter may provide the basis for greater reliance on the commercial sector in the future, unencumbered by A-76 requirements. However, the extent to which conversions, outsourcing, or eliminations are likely to occur is not now known.

It is uncertain whether DOD will be able to complete A-76 studies within the time frames outlined in the revised handbook. The handbook states that studies of single activities should be completed within 18 months and studies of multiple activities should be completed within 36 months. According to DOD data, cost studies have averaged 2 to 4 years. In July 1991, we reported that DOD averaged 4 years and 3 months to complete A-76 studies during fiscal years 1987 and 1990.¹⁹ Further, service officials told us the procurement process that typically follows the A-76 study, takes time. For example, a large-scale effort to outsource aircraft maintenance at Altus Air Force Base, Oklahoma, took 23 months, 17 of which involved some contracting actions. The A-76 study took place concurrently with roughly one-half of the procurement process. The services have various initiatives underway to streamline the A-76 process, including using work statement templates, assembling A-76 teams of experts to conduct studies, and outsourcing the A-76 study process to industry. However, most officials we spoke with said that the time involved in following the federal procurement process lengthened the outsourcing process.

Despite changes to the factors used to cost in-house performance, such as the costing of overhead, industry representatives testified in September 1996 before the Senate Committee on Governmental Affairs that cost comparisons between the public and private sectors will continue to be difficult due to differing accounting structures and budgeting processes. The services have some initiatives to improve in-house cost determinations, but efforts are in the early stages.

Resources to Manage the A-76 Program

Installation officials have expressed concern about the availability of resources to conduct A-76 studies and manage the program. In the past, most studies were done using in-house staff. At most installations we visited, we were told that, as a result of downsizing, they had lost many personnel who were experienced in the A-76 program. For example, officials at one Navy command said that during the 1980s they had about 70 staff who administered the commercial activities program commandwide. Since then, the command had lost all field staff and all but two staff at headquarters to administer the program. To help alleviate this problem, both the Navy and the Army plan to outsource parts of the A-76 study process, although portions will be retained in-house, such as costing of the in-house organization. OSD provided \$14.5 million in near-term

¹⁹OMB Circular A-76: Legislation Has Curbed Many Cost Studies in Military Services (GAO/GGD-91-100, July 30, 1991).

funding to the services for A-76 studies. Air Force officials told us they are considering augmenting the study process with contractor personnel. Marine Corps officials told us they have not decided how they will conduct A-76 studies.

Legislation Affecting Outsourcing

Various laws have affected DOD's outsourcing efforts. Key provisions—which allowed installation commanders to determine whether to conduct A-76 studies and prohibited the award of contracts resulting from such studies—have lapsed. Yet a number of provisions in chapter 146 of title 10 continue to affect outsourcing.

Chapter 146 of title 10 contains various provisions that burden or restrict DOD's outsourcing.²⁰ Section 2461 of title 10 requires A-76 cost comparison studies, congressional notification of studies involving more than 45 civilians, and annual reports to Congress on outsourcing. Section 2465 of title 10 prohibits DOD from outsourcing civilian firefighters or security guards at military installations. DOD's fiscal year 1996 inventory of civilian and military personnel involved with commercial activities shows that about 9,600 firefighters and 16,000 security guards were exempt from outsourcing because of the law and considerations such as mobility requirements. Outsourcing of these positions was permitted only if positions were outsourced before September 24, 1983. Various service officials expressed concern about the exclusion of these functions from the A-76 process, from an equity standpoint.

Agency Comments and Our Evaluation

In commenting orally on a draft of this report, DOD expressed the belief that our concern about the effect of cost growth on competition savings was overstated. DOD stated that cost growth may indeed result from changes in the scope of work, but changes in the scope of work can occur to any workload, including those which DOD never subjects to competition. We recognize that cost growth can occur under either circumstance; however, circumstances associated with outsourcing competitions have made this a troublesome issue for many service officials. Historically, this has included difficulty in drafting performance work statements that fully capture work to be done, as well as mandated wage increases that sometimes occur under the Davis-Bacon and Service Contract acts. Our report recognizes the importance of competition to achieving operating efficiencies and cost savings, but at the same time expresses an

²⁰Some of the provisions in chapter 146 apply only to depot-level maintenance and, therefore, do not affect the outsourcing of base support services.

appropriate level of caution about the potential for large-scale savings from outsourcing competition in today's operating environment.

DOD also pointed out that it has programmed investment funds necessary to provide the resources to conduct the A-76 studies needed to reach the services' savings goals. Our report recognizes the initial provision of these resources for the services' recently announced studies. However, providing initial funding to facilitate outsourcing competition studies does not necessarily translate into achievement of the savings goals, and does not eliminate concerns about having sufficient personnel to manage the program over time.

DOD also provided several technical comments to enhance the accuracy and completeness of the report and we have incorporated them in the text where appropriate.

Our scope and methodology are discussed in appendix III.

We are sending copies of this report to the Chairmen of the Senate Committees on Armed Services and on Appropriations, House Committees on National Security and on Appropriations; the Secretaries of Defense, the Air Force, the Army, and the Navy; and the Director of OMB.

Please contact me at (202) 512-5140 if you or your staff have any questions concerning this report. Major contributors to this report were Christine Frye, Barry Holman, and Martin Scire.

Sincerely yours,



Mark E. Gebicke
Director, Military Operations
and Capabilities Issues

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Figure 1: In-house DOD Commercial Activities

Abbreviations

CNA	Center for Naval Analyses
DFARS	Defense Federal Acquisition Regulation Supplement
DOD	Department of Defense
FAR	Federal Acquisition Regulation
GSA	General Services Administration
O&M	operations and maintenance
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense

Summary of 1996 Changes to Circular A-76 Handbook

The revised supplemental handbook to Office of Management and Budget (OMB) Circular No. A-76 expands the authority to waive studies, limits the length of studies, standardizes the costing methodology, and encourages the consideration of contract performance and best value.

A cost comparison study may be waived where (1) the conversion will result in a significant financial or service quality improvement and will not significantly reduce the level or quality of competition in the future award or performance of work or (2) the waiver will establish why in-house or contract offers cannot reasonably be expected to win a competition under the cost comparison process. The revised handbook indicates that no one lower than the service Assistant Secretary may grant a waiver.

Under the revised handbook, A-76 cost studies are to be completed within 18 months for single activities and 36 months for multiple activities.

The revised handbook includes various changes to the factors to be used to cost in-house performance in an effort to balance the comparison of government costs to industry. For example, under the revised handbook, government overhead is calculated based on a standard factor of 12 percent of direct labor costs. In the past, private industry contended that government costing was inherently unfair to industry because the government understated its cost of in-house performance.

The revised handbook places increased emphasis on consideration, during the review of industry offers, of the best overall value to the government. The government may select a contractor based on the quality of past performance, as well as cost.

Base Operating Support Functions

Base commercial activities, also called base support, are the functions necessary to support, operate, and maintain Department of Defense (DOD) installations. The revised supplemental handbook to OMB Circular No. A-76 defines base support as the following 29 services:

- Natural resource services
- Advertising and public relations
- Financial and payroll services
- Debt collection
- Bus services
- Laundry and dry cleaning
- Custodial services
- Pest management
- Refuse collection and disposal services
- Food services
- Furniture repair
- Office equipment maintenance and repair
- Motor vehicle operation
- Motor vehicle maintenance
- Fire prevention and protection
- Military clothing
- Guard service
- Electric plants and systems operation and maintenance
- Heating plants and systems operation and maintenance
- Water plants and systems operation and maintenance
- Sewage and waste plants operation and maintenance
- Air conditioning and refrigeration plants
- Other utilities operation and maintenance
- Supply operations
- Warehousing and distribution of publications
- Transportation management services
- Museum operations
- Contractor-operated parts stores and civil engineering supply stores
- Other installation services

Although OMB's supplemental handbook lists all these functions as base support, DOD does not have a generally accepted definition of base support activities, and the services differ in how they define base support activities. For example, the Army's Cost and Economic Analysis Center identified 122 functions supporting Army installations. The Center for Naval Analyses developed a working definition of 37 different functions

supporting Navy installations. Air Force officials told us that they did not have a definition for base operating support and that functions included as base support may differ across the service. According to a cognizant Marine Corps official, the Marine Corps does not have a standardized definition for base operation support.

Without a common definition of base support, it is difficult to accurately determine the size and cost of DOD's base support workforce. In fiscal year 1994, DOD estimated it had 629,000 military and civilians involved in commercial activities in house. In 1996, DOD revised its inventory and estimated it had about 449,000 personnel involved in those activities. This significant revision reflects a change in what the Air Force considered commercial activities. According to Air Force officials, a number of functions were deleted from the Air Force inventory because DOD considered them inherently governmental. DOD's inventory total also changed, according to officials, because the services had recently surveyed their databases and added and deleted various functions.

Some support services common to military installations are neither part of the A-76 handbook definition nor the services' varied definitions of base support. For example, family housing maintenance and repair is a common base support service. Yet, the A-76 definition of base support does not include family housing maintenance. Further, installation officials told us that they did not consider family housing maintenance a part of base support for budgeting purposes.

Objectives, Scope, and Methodology

For this report, we determined (1) the extent to which DOD and the services emphasize the outsourcing of base support services, (2) the factors that influence savings in the outsourcing process, and (3) impediments to DOD outsourcing. We focused our review on the outsourcing of base support-type functions because DOD expects the streamlining of infrastructure, of which base support is a major component, to yield significant savings to fund weapons procurement.

To determine how current DOD and service efforts to outsource compare with those of prior years, we analyzed DOD's database of A-76 cost comparison studies conducted since 1978. Due to the size and complexity of the DOD database, we did not validate the accuracy of the data. We determined the cost of base support activities using DOD's definition of base support in its budget and discussions with Office of the Secretary of Defense (OSD) officials on what portions of base support to include. We reviewed DOD and industry studies on DOD's A-76 program and an extensive number of our reports. We spoke with responsible service and OSD officials about the environmental influences on outsourcing in DOD and current efforts to outsource support activities. On a limited basis, we also discussed outsourcing with industry officials.

To determine the reasonableness of DOD's projected cost savings from outsourcing, we selectively analyzed DOD's database of A-76 cost comparison studies to determine average cost savings projected and savings trends. We also used DOD's database to trace in-house activities to an updated listing of installation activities. We demonstrated that installation activities and staffing change and that tracking savings is difficult. We discussed the various institutional, procedural, and legislative effects on savings with responsible service headquarters, installation, and OSD officials. On a limited basis, we discussed installation officials' experiences with specific contracts.

To determine what factors currently constrain DOD's outsourcing efforts, and efforts to correct problems, we spoke with responsible service headquarters and installation officials. We researched laws cited by officials and discussed specific legislation, such as the Small Business Act, with OSD officials and the services' small business offices.

The majority of our work was done in Washington, D.C. Work was also done at the U.S. Atlantic Fleet, Norfolk, Virginia; U.S. Army Training and Doctrine Command, Fort Monroe, Virginia; U.S. Army Forces Command, Atlanta, Georgia; the Air Force Air Education and Training Command, San

Appendix III
Objectives, Scope, and Methodology

Antonio, Texas; the Air Force Air Combat Command, Langley, Virginia; and the Air Force Materiel Command, Wright-Patterson Air Force Base, Ohio. We performed our review from May 1996 to February 1997 in accordance with generally accepted government auditing standards.

Related GAO Products

Air Force Maintenance: Privatization-in-Place Plans Are Costly While Excess Capacity Exists (GAO/NSIAD-97-13, Dec. 31, 1996).

Navy Depot Maintenance: Cost and Savings Issues Related to Privatizing-in-Place at the Louisville, Kentucky, Depot (GAO/NSIAD-96-202, Sept. 18, 1996).

Army Depot Maintenance: Privatization Without Further Downsizing Increases Costly Excess Capacity (GAO/NSIAD-96-201, Sept. 18, 1996).

Defense Depot Maintenance: Commission on Roles and Mission's Privatization Assumptions Are Questionable (GAO/NSIAD-96-161, July 15, 1996).

Defense Depot Maintenance: DOD's Policy Report Leaves Future Role of Depot System Uncertain (GAO/NSIAD-96-165, May 21, 1996).

Military Bases: Opportunities for Savings in Installation Support Costs Are Being Missed (GAO/NSIAD-96-108, Apr. 23, 1996).

Defense Depot Maintenance: Privatization and the Debate Over the Public-Private Mix (GAO/T-NSIAD-96-148, Apr. 17, 1996).

OMB Circular A-76: Legislation Has Curbed Many Cost Studies in the Military Services (GAO/GGD-91-100, July 30, 1991).

OMB Circular A-76: Expected Savings Are Not Being Realized in Ft. Sill's Logistics Contract (GAO/GGD-91-33, Feb. 11, 1991).

OMB Circular A-76: DOD's Reported Savings Figures Are Incomplete and Inaccurate (GAO/GGD-90-58, Mar. 15, 1990).

Army Procurement: Fort Benjamin Harrison's Commercial Activity Study Should Be Redone or Updated (GAO/NSIAD-89-90, Feb. 24, 1989).

Federal Productivity: DOD's Experience in Contracting Out Commercially Available Activities (GAO/GGD-89-6, Nov. 28, 1988).

Army Procurement: No Savings From Contracting for Support Services at Fort Eustis, Virginia (GAO/NSIAD-89-25, Oct. 31, 1988).

Air Force Contracting: Contracting for Maintenance of Training Aircraft at Columbus Air Force Base (GAO/NSIAD-88-136BR, Apr. 6, 1988).

Federal Productivity: DOD Functions With Savings Potential From Private Sector Cost Comparisons (GAO/GGD-88-63FS, Apr. 8, 1988).

DOD Functions Contracted Out Under OMB Circular A-76: Costs and Status of Certain Displaced Employees (GAO/NSIAD-85-90, July 12, 1985).

Information From Previous Reports on Various Aspects of Contracting Out Under OMB Circular A-76 (GAO/NSIAD-85-107, July 5, 1985).

DOD Functions Contracted Out Under OMB Circular A-76: Contract Cost Increases and the Effects on Federal Employees (GAO/NSIAD-85-49, Apr. 15, 1985).

Synopsis of GAO Reports Involving Contracting Out Under OMB Circular A-76 (GAO/PLRD-83-74, May 24, 1983).

Review of DOD Contracts Awarded Under OMB Circular A-76 (GAO/PLRD-81-58, Aug. 26, 1981).

Factors Influencing DOD Decisions to Convert Activities From In-house to Contractor Performance (GAO/PLRD-81-19, Apr. 22, 1981).